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IN THE

Supreme Court of the United States

OCTOBER TERM, 1939.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

S. C. THOMSON,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Brief for Respondent in Opposition to Petition for Writ of Certiorari.

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No. 946.

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Opinions Below.

The opinion of the Board of Tax Appeals (R. 10-15) is reported at 40 B. T. A. 60. The opinion of the Circuit Court of Appeals (R. 72) is reported in 108 F. (2d) 642.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered January 25, 1940 (R. 74). On April 25, 1940, petitioner filed a petition for writ of certiorari, invoking the jurisdiction of this Court under Section 240 (a) of the Judicial Code as amended.

Statement of Case.

In May, 1927, respondent, taxpayer, at a cost of $24,750 purchased $25,000 face amount of New York United Hotels, Inc., 20 year 6% sinking fund gold debentures maturing February 1, 1947 (R. 23). The debtor was organized to lease and operate the Roosevelt Hotel in New York City (R. 28). Its assets consisted of the lease, and the furnishings and equipment of the hotel (R. 28, 32). In 1931 the debtor encountered financial difficulties as a result of which the debenture holders agreed to postpone payment of certain of their interest coupons until the maturity of the debentures and to waive the payment of a portion of the sinking fund installments required under the indenture (R. 28-30). On December 15, 1933 ancillary receivers were appointed by the United States District Court for the Southern District of New York (R. 24).

A plan of reorganization (R. 34-42) was submitted to the Court by a reorganization committee, under which a new corporation was to be formed to purchase all the assets of the debtor and either negotiate a new lease with the lessor or obtain an assignment of the existing lease with important modifications; the new corporation was to issue debentures, preferred and common stock; and substantially all the new debentures ($1,205,000) were to go to the lessor in satisfaction of the debtor's indebtedness to it (R. 41). The plan offered to respondent and other debenture holders of the debtor the choice of acquiring stock of the new company in exchange for the old debentures, or of acquiring both debentures and stock of the new company in exchange for the old debentures plus a cash payment (R. 40).

This plan was approved by Judge Coxe in the District Court (R. 47-55) and by final order of May 22, 1934 (R. 58-62), Judge Coxe directed, among other things, that debenture holders and other creditors of the debtor not participating in the plan should be entitled to be paid

out of the cash balance in the hands of the receivers the sum of $5 per $1,000 face value of debentures or other claims upon surrender of the debentures or assignment of the claims on or before August 20, 1934 (R. 62).

Pursuant to Judge Coxe's final order respondent surrendered his debentures on June 22, 1934, and received a payment of $125 (R. 25).

Subsequently the action taken by the District Court was appealed by a debenture holder to the Circuit Court of Appeals for the Second Circuit, and there affirmed (*Rockwell v. New York United Hotels, Inc.* [1935], 79 F. [2nd] 81).

Questions Presented.

In his income tax return for 1934 respondent deducted from his gross income as a bad debt under Section 23 (k) of the Revenue Act of 1934 his loss of $24,625 on the New York United Hotels, Inc., debentures. Petitioner, Commissioner of Internal Revenue, disallowed the deduction, holding that the $125 payment made to respondent under order of Judge Coxe constituted "an amount received upon the retirement" of the debentures, within the meaning of Section 117 (f) of the Revenue Act of 1934; and that consequently respondent's loss became a loss from an exchange of capital assets within the meaning and subject to the limitations of Section 117 (d) of the same act. The Board of Tax Appeals affirmed petitioner and the Circuit Court of Appeals for the Second Circuit reversed.

The question at issue was whether the phrase "amounts received upon the retirement of corporate bonds" as used in Section 117 (f) of the Revenue Act of 1934, covers the payment made to respondent by the receiver under order of Judge Coxe. The Circuit Court of Appeals held that what happened with respect to the New York United Hotels, Inc., bonds may not fairly be taken as re-

tirement of the bonds because the word "retirement" signifies some voluntary action on the debtor's part in fulfillment of his promise to pay—action which was not present in the case at bar (R. 73).

Petitioner claims that the transaction shown by the record constituted a "retirement" of the bonds within the meaning of Section 117 (f) of the Revenue Act; and that the decision below is in substantial conflict with the decision of the Circuit Court of Appeals for the Fifth Circuit in *McClain v. Commissioner,* decided March 23, 1940 (not yet officially reported but published in Vol. 4, Prentice Hall, Federal Tax Service, 1940, par. 62, 518).

Argument.

The statement given in the petition herein shows on its face that there is no conflict between the decision in this case and the decision in the *McClain* case. The two sets of facts are as different as positive and negative; and the two decisions, taken together, define clearly what is and what is not a "retirement" within the meaning of Section 117 (f) of the Revenue Act.

In the *McClain* case the debtor paid off its bonds at approximately fifty cents on the dollar out of a Reconstruction Finance Corporation loan without receivership or bankruptcy and thereafter continued its existence and activities. That was obviously a "retirement" of the bonds because they were voluntarily taken back by the debtor itself.

But in the case at bar the debtor went out of business and existence, its assets were taken over by receivers in insolvency proceedings and were sold by them, and the proceeds—a mere one-half cent on the dollar—were distributed among bondholders and other creditors. That was obviously not a "retirement" of the bonds because they were not taken back by the debtor but were simply extinguished by a first and final liquidation dividend out

of the proceeds of sale of the defunct debtor's assets effected by receivers appointed by the Court for the benefit of creditors.

The so-called plan of reorganization in the case at bar (Petition, p. 3) was not for the reorganization of the debtor but was merely a plan under which bondholders of the debtor might, if they so desired, acquire bonds and stock of the new corporation (which had bought the assets from the receivers) by turning in their bonds to the new corporation and paying cash in addition.

The asserted "conflict" between the decision in the case at bar and the decision in the *McClain* case rests upon nothing more than that in both cases the Commissioner claimed a "retirement" and that in the case at bar the Court properly decided in favor of the taxpayer, while in the *McClain* case the Court properly decided in favor of the Commissioner. In other words, there is no conflict between the decisions but merely a fundamental difference between the two sets of facts. And such a difference, it is submitted, furnishes no basis for invoking the jurisdiction of this Court under Section 240 (a) of the Judicial Code.

Wherefore it is respectfully submitted that the application for a writ of certiorari should be denied.

T. F. DAVIES HAINES,
Respondent's Counsel.

May, 1940.

Appendix.

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:

* * * * *

(j) *Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117 (d).

(k) *Bad Debts.*—Debts ascertained to be worthless and charged off within the taxable year (or, in the discretion of the Commissioner, a reasonable addition to a reserve for bad debts); and when satisfied that a debt is recoverable only in part, the Commissioner may allow such debt, in an amount not in excess of the part charged off within the taxable year, as a deduction.

* * * * *

[U. S. C., Title 26, Sec. 23.]

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *General Rule.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 1 year;

80 per centum if the capital has been held for more than 1 year but not for more than 2 years;

60 per centum if the capital asset has been held for more than 2 years but not for more than 5 years;

40 per centum if the capital asset has been held for more than 5 years but not for more than 10 years;

30 per centum if the capital asset has been held for more than 10 years.

(b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. If a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits, sells any bond, debenture, note, or certificate or other evidence of indebtedness issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, any loss resulting from such sale (except such portion of the loss as does not exceed the amount, if any, by which the adjusted basis of such instrument exceeds the par or face value thereof) shall not be subject to the foregoing limitation and shall not be included in determining the applicability of such limitation to other losses.

* * * * *

(f) *Retirement of Bonds, Etc.*—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor. [U. S. C., Title 26, Sec. 101.]